

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
RUTH FOSTER }

For Appellant: Ruth Foster, in pro. per.

For Respondent: Crawford H. Thomas  
Chief Counsel

Joseph W. Kegier  
Tax Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Ruth Foster for refund of personal income tax in the amounts of \$26.00 and \$35.00 for the years 1964 and 1965, respectively.

In 1964 appellant was employed by the Welfare Department of Napa County, California. This department participates in a public assistance program for the educational development of welfare department employees. The program is jointly administered by the California Department of Social Welfare and the United States Department of Health, Education and Welfare. Federal funds provide the primary financing. The purpose of the program is to assist county welfare departments in achieving proper and effective administration of their welfare programs by providing them with more highly skilled employees. Each employee accepted into the program is given educational leave and monthly stipend payments, Sections SD-530.10, .35(.62) and SD-540.25, .60(.2) of the California-SDS\?-Manual state that the employee retains his seniority, sick leave, retirement, OASDI, workman's compensation, and health insurance rights. School vacation is considered in lieu of regular vacation benefits.

Appeal of Ruth Foster

Appellant was accepted into the program for a period of two school years. A standard agreement was executed by her and the Napa County Welfare Department reciting that after graduation appellant would either return to work for the department for two years or repay the stipend funds received. During the period from July 1, 1964, to June 30, 1966, appellant received monthly stipend checks totaling \$5,005.00. In June of 1966 she elected to repay the above sum rather than return to work. A schedule was agreed upon of one \$140.00 payment on December 15, 1966, to be followed by thirty-five payments of \$139.00 per month.

In her tax returns for 1964 and 1965 appellant, a cash basis taxpayer, reported stipend funds of \$1,300.00 and \$2,630.00, respectively, as gross income. Subsequently, she filed claims for refund with regard to those years, contending that the inclusion of the stipend payments was erroneous. Respondent denied the claims.

The first issue is whether these stipend payments may be excluded from gross income under section 17150 of the Revenue and Taxation Code. If these payments must be included in gross income, the second issue involves the effect of the appellant's repayment of these funds in later years.

Section 17150 of the Revenue and Taxation Code excludes from gross income amounts received as scholarship and fellowship grants. Regulation 17150(d), title 18, California Administrative Code, helps define these two terms.

Reg. 17150(d). Items Not Considered  
as Scholarships or Fellowship Grants.

\* \* \*

(3) Amounts Paid as Compensation for Services or Primarily for the Benefit of the Grantor. (A) Except as provided in Reg. 17150(b)(1), any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research, if such amount represents either compensation for past, present, or future employment services or represents payment for services which are subject to the direction or supervision of the grantor.

Appeal of Ruth Foster

(B) Any Amount Paid or Allowed to, or on Behalf of, an Individual to Enable Him to Pursue Studies or Research Primarily for the Benefit of the Grantor. However, amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant for the purpose of Section 17150 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amounts provided by the grantor for such purpose does not represent compensation or payment for the services described in subparagraph (A) of this paragraph. Neither the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results of his studies or research may be of some incidental benefit to the grantor shall, of itself, be considered to destroy the essential character of such amount as a scholarship or fellowship grant.

The above statute and regulation are substantially the same as section 117 and regulation 1.117-4(c) of the federal Internal Revenue Code and regulations. There have been two federal circuit court cases decided on facts almost identical to the instant situation. Both of these cases held that section 117 of the Internal Revenue Code did not apply and therefore the stipend payments had to be included in gross income. In Ussery v. United States (1961) 296 F.2d 582, the Fifth Circuit Court pointed out that the grant was very similar to the employee's previous salary and benefits, and that the department had declared that the purpose of the program was to improve the department's efficiency and effectiveness. The court concluded that the grant was to enable the taxpayer to pursue studies primarily for the benefit of the grantor within the meaning of regulation 1.117-4(c)(2). More recently the Sixth Circuit Court in Stewart v. United States (1966) 363 F.2d 355, held that such a grant represents compensation for past, present or future services under regulation 1.117-4(c)(1). The court stressed the close resemblance of the grant to the previous salary and benefits received by the taxpayer.

Appeal of Ruth Foster

Appellant's fact situation is very close to the Ussery and Stewart cases, supra. The express purpose of the program and the close similarity of the grant to appellant's previous salary and employment benefits demonstrate that these stipend payments fall under regulation 17150(d), subdivision (3)(A), (B), as either compensation for past, present or future services, or as an amount paid to the taxpayer to enable her to pursue studies primarily for the benefit of the grantor. We therefore conclude that the stipend payments received by appellant were not scholarship or fellowship grants excludible from gross income under section 17150 of the Revenue and Taxation Code:

The second issue in the instant appeal concerns the effect of the taxpayer's repayment of the stipend funds in later years. Appellant contends that the effect should be to allow her to amend the 1964 and 1965 returns, deleting the stipend funds included in gross income. But this contention is contrary to well settled principles.

The United States Supreme Court has held that a taxpayer must report earnings received under a claim of right and without restriction as to their disposition, even though he may be required to restore them in the future. (North American Oil Consolidated v. Burnet, 286 U.S. 417 [76 L. Ed. 1197].) **If subsequent repayment is made, the taxpayer is entitled to a deduction from gross income in the years of repayment, not from gross income in any earlier year.** (North American Oil Consolidated v. Burnet, supra.) This board has applied the above rule as recently as 1966 in Appeal of George M. and Elizabeth R. Cuthbertson, Cal. St. Bd. of Equal., March 8, 1966.

Since appellant's situation is directly within the above rule, we conclude that the stipend funds received by her in 1964 and 1965 were correctly included as gross income in her returns for those years. As appellant repays these funds she will be entitled to deductions in the repayment years.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Ruth Foster

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Ruth Foster for refund of personal income tax in the amounts of \$26.00 and \$35.00 for the years 1964 and 1965, respectively, be and the same is hereby sustained.

Done at Sacramento , California, this 8th day  
of January , 1968; by the State Board of Equalization.

Paul R. Leake, Chairman  
John W. Lynch, Member  
Robert H. Smith, Member  
Robert H. Smith, Member  
Robert H. Smith, Member

ATTEST:

J. H. Brown, Secretary